

Utah Division of Securities

QUARTERLY NEWSLETTER

Special points of interest:

- *Finders may need to be licensed as broker-dealers.*
- *Brokering investment notes may violate the law.*
- *Fraudulent oil and gas offerings are prevalent.*
- *Thirty enforcement cases are described.*

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Finders

What is a finder? There is an industry made up of people who offer to match businesses with capital. These intermediaries often are described as "finders." Finders may tell small business owners or entrepreneurs that the finders can identify venture capitalists or other wealthy investors willing to infuse money into the business. For his services, the finder will be compensated, often with a percentage of the amount invested. In most cases, the finder promises that most or all of the fee will be paid only if the finder succeeds in securing an investment.

What the law requires. Few finders realize that this conduct may constitute the giving of investment advice or the offering of securities. If the finder's conduct constitutes investment advice or an offer of securities, the finder probably needs to be licensed.

The Utah Uniform Securities Act defines a broker-dealer agent as one who effects or attempts to effect purchases or sales of securities. An invest-

ment adviser is a person who engages in the business and receives compensation for advising others as to the value of securities or the advisability of investing in, purchasing or selling securities.

What is a security? These definitions beg the question: What is a security? In this context, a security exists when an investor gives money to a small business or entrepreneur in exchange for an interest in the company or a promise to repay the investment. The investment might be represented by debt or equity. If the investor is buying equity in the company, it is a security. If the business is obtaining a loan, whether it is treated as a security will depend on several factors, primarily looking to see whether the lender is a financial institution or an investor.

In essence, if the money comes from someone

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Note Brokering

The Division is being flooded with calls from citizens who have set up businesses to broker real estate notes, only to discover that this business requires a securities license.

A Colorado company, America's Note Network (ANN),

advertises on the Internet and through infomercials that it can teach investors how to purchase real estate notes at a discount, list them on the 'Note Network' web site, and resell them at a profit. ANN claims investors can start their own "successful in-home note busi-

ness" and make thousands of dollars in cash profits. According to ANN, there are over \$90 billion in owner-financed trust deeds and mortgages nationwide and most of the holders of those notes would like to sell.

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Finders - Continued from page 1



This problem can affect more than just independent “finders.” Business brokers may unwittingly be conducting securities business without realizing it.



other than a financial institution, it is likely to be a security and the seller – the finder – probably is required to be licensed.

National Problem. This is an issue of concern nationally. Many people in the investment industry recognize the extent to which conduct like this occurs without the finders having securities licenses. A committee of the American Bar Association is examining the problem and searching for a solution. Advisory committees to the SEC have urged a resolution as a means of facilitating small business capital formation. Several states, including Texas and South Dakota, have attempted to create a simplified licensing process for finders or to expand the conduct that is permissible without having a license.

This problem can affect more than just independent “finders.” Business brokers may unwittingly be conducting securities business without realizing it. For example, if the business broker is attempting to sell an ongoing business and a buyer wants to buy not only the business, but also the corporate entity that owns a business, that transaction involves the purchase of stock. If the business broker participates in negotiations over the structure of a stock sale, that broker likely is giving investment advice or offering to sell securities. Such conduct may require a securities license.

This topic was addressed superbly by Salt Lake City lawyers

Brad Jacobsen and Olympia Fay in an article in the April issue of the Utah Bar Journal: *Finding a Solution to the Problem with Finders in Utah*. (available at www.utahbar.org/barjournal/archives/2006/04/index.html).

How much can an unlicensed finder do? A finder may engage in activities that fall short of offering securities or giving investment advice. A finder can recommend potential investors to small business owners and can receive compensation for such referrals. But, the finder cannot be an intermediary in that transaction, talk to the investor about the company seeking capital, or negotiate the terms of an investment.

Limited Exemptions. The licensing requirement generally would not apply to accountants and lawyers who are working for the business/entrepreneur, so long as the professional’s “finding” work is incidental to his accounting or legal work (which also would require that compensation not be contingent on finding an investor). Employees of the company may be exempt so long as the employee does not receive commissions. However, the employee might still need to be licensed as an issuer agent. Finally, if a company is selling its assets, rather than its stock, the transaction might not involve the sale of securities.

Solution? Under the current law, a finder who violates the securities laws in essence guar-

antees the happiness of both parties to the transaction. If the finder is found to have offered securities without a license, the seller and the buyer can demand that the finder rescind the transaction. Liability to the state also is huge; sanctions can be administrative, civil, or criminal and might include the imposition of large fines and the preclusion of the finder from ever obtaining a securities license in the future. The business also can be sanctioned for employing unlicensed securities agents.

The Division of Securities wants to assist in finding a solution – within the constraints of the law. Possible solutions include changing the law, having finders become licensed as broker-dealers or investment advisers, encouraging finders to limit their conduct to that permitted under the law, and granting no-action relief for conduct that is consistent with the intent of the law. For now, the Division is waiting to see if a national solution develops, rather than pursuing a Utah-only approach.



News on “Fails To Deliver” Legislation

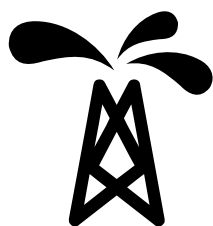
As noted in the July newsletter, the Utah legislature passed a bill in May requiring broker-dealers to report information to the Division about trades that fail to settle on time. The bill was signed by the Governor and went into effect on July 1, 2006.

On July 28, 2006, the Securities Industry Association filed suit alleging that the Utah law was preempted by the National Securities Markets Improvement Act of 1996. The state agreed to postpone the October 1 date on which firms were required to

begin filing reports, to allow broker-dealers to express concerns to the legislature. If the legislature makes no change, the federal court will be expected to rule on the validity of the law.

Oil and Gas Offerings

“Promoters in these types of offerings may be misrepresenting the tax benefits of depletion allowance credits leading unwary investors to believe they face little risk.”



With abnormally high oil prices fattening the profits of oil companies and spurring new oil exploration, the Division is seeing a dramatic increase in problematic investment offerings involving oil and gas. These problems are surfacing with fraudulent offerings, Regulation D offerings, and investment programs that assert they do not involve the offer or sale of securities.

A review of the enforcement summaries at the end of this newsletter reveals several fraudulent offerings in which residents were offered oil investments. Other cases are being investigated in which the promoters claim to have access to previously undeveloped oil fields or new technology that will make it economically profitable to extract oil from old wells or from new sources, such as oil shale.

Problems are even being seen with issuers who are filing their offerings with the Division. In one Regulation D offering, the prospectus failed to disclose that another state had ordered the

company to cease and desist violating the securities laws of that state. In addition, an affiliated promoter had an extensive criminal record (involving arson, mail fraud, money laundering, perjury, and hazardous waste violations) that had not been disclosed. The sponsors of the offering claimed they were unaware of the criminal history. The lack of knowledge highlights the importance of due diligence for promoters of securities offerings. The Division is insisting that the criminal convictions be disclosed prominently.

In a registration application, the promoters of an oil company with no income and no oil leases structured the offering to give \$4.5 million in “founder’s interests” to insiders. (The insiders had invested \$200 in the company). The Division required that the \$4.5 million founder’s interest be reflected in the financial statements. The financial statements also included a “going concern” opinion by the accountant and designated the

company as “development stage.” The company withdrew its application.

A third area of concern is the sale to investors of general partnership interests. A recent Wall Street Journal story, *Oil Rush Lures Small Investors*, Wall St. J., Oct. 10, 2006 at C1, describes how many investors are buying stakes in actual oil wells through partnerships. According to the article, fraud in such partnerships is rife with some investors losing 90% or more of their money. Fees are high, with 30% administrative fees and the driller taking 25% of any oil income. The Division is evaluating whether an out-of-state seller of oil and gas partnerships should be subject to the securities laws for sales in Utah.

The Division is further concerned that promoters in these types of offerings are misrepresenting the tax benefits of depletion allowance credits, leading unwary investors to believe they face little risk.

Note Brokering - Continued from Page 1

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Investors pay ANN to teach them how to buy notes from these holders at a discount, list the notes on the ANN web site, then find another investor willing to purchase the note (and the accompanying payment stream) at a profit.

What the students in the course do not realize is that to implement the strategy taught by ANN requires that the note

seller be licensed as a broker-dealer. In essence, ANN teaches investors how to be unregistered broker-dealers. ANN does not buy and sell the notes itself, it only teaches investors how to broker notes. The company insists that it is the responsibility of students to comply with the securities laws.

When the investors realize that they cannot engage in this business without becoming licensed

as broker-dealers, they feel cheated. A few have been able to get refunds from ANN. The Division is investigating the extent to which other ANN graduates are brokering notes without being licensed and whether ANN's involvement by sponsoring the web site makes it liable for violations.

"In essence, [the company] teaches investors how to be unregistered broker-dealers."

Enforcement

Summary of Actions

Enforcement actions initiated or concluded during the second quarter of 2006 are listed below. Copies of enforcement orders entered by the Division can be found at www.securities.utah.gov.

Remember: in criminal prosecutions, defendants are presumed innocent until proven guilty, or until a plea is entered.

July 7, 2006. **Douglas E. Gish** and his wife, **Justice Lynn Gish**, of Sandy, were convicted of securities fraud for taking \$159,000 from a woman with a promise the money would be invested in securities and commodities. The victim was not told that Douglas Gish had numerous prior convictions for securities fraud. Douglas was sentenced to five years in prison and ordered to pay restitution and a fine. Justice Gish pleaded to a third-

degree felony and must pay restitution within three years. The case was prosecuted by the Utah Attorney General.

July 17, 2006. Six second-degree felony criminal charges were filed by the Attorney General against **Jennifer Robyn Burkinshaw**, for defrauding five victims of \$123,000 for a nightclub venture. She sold notes promising interest rates of 10-15%, saying the money would be used to open two Salt Lake nightclubs. She failed to disclose she had unpaid judgments and did not have licenses to operate the clubs.

July 17, 2006. **Travis J. Arnovick** of Salt Lake County admitted taking \$20,000 from two investors to share in the profits of the Lazy Moon nightclub. He admitted failing to disclose adequate information to the investors. He paid restitution in connection with prior

criminal prosecution. He was ordered to cease and desist from committing any further violations of the Utah Securities Act. Docket No. SD-05-0026.

July 17, 2006. A cease and desist order was issued against **Windemere Capital, LLC** of Las Vegas for selling investments in real estate trust deeds without registering the offering. Windemere consented to the order, paid a \$5,000 fine, and will offer rescission to all the investors in Utah. Windemere advertised trust deed investments from an office in Midvale. The company failed to give adequate information to investors about the company and its profitability. Windemere has closed its Utah office. Docket No. SD-06-0044.

July 17, 2006. **Kevin L. Wright** of Washington, County and **Michael S. Hurst**

"The victim was not told that Douglas Gish had numerous prior convictions for securities fraud."



Enforcement

of Fruit Heights pleaded guilty to third degree felonies for a real estate equity-skimming scheme in which they persuaded an investor to obtain \$810,000 in loans on a \$590,000 home. Wright and Hurst then took the difference, promising to invest it in a high-yield mutual fund. Instead, the money was used for personal expenses of the promoters. The case was prosecuted by the Attorney General.

July 25, 2006. The Attorney General filed felony criminal charges against **Thomas Mitchell Johnson** of Burbank California for selling \$45,000 worth of stock to an investor. Johnson did not own the stock. Johnson told the investor that the money would give him a 1% interest in a British company, Telesecure. Johnson also is accused of stealing \$35,000 from the victim's bank account. Johnson failed to tell the investor that he had prior criminal charges for grand theft and forgery.

July 25, 2006. **Janelle M. Garner** of Ogden pleaded guilty to one felony count of securities fraud. Garner owned and operated the Attitude Adjustment Factory, a company that teaches mental skills to nurture positive interaction between parents and children. In 2001, Garner was ordered by the Division to cease and desist selling unregistered securities. When she violated that cease and desist order, the Attorney General filed criminal charges in 2005. The felony charges also accused

Garner of not telling investors about prior unpaid judgments or disclosing risks.

Aug. 3, 2006. An Order to Show Cause was issued against **Bruce W. Anderson** and his wife **Nelly**, of Logan. The OSC alleges that the Andersons conned nine investors to give them \$596,000 for a variety of investments including stock in companies Anderson controlled. The investments were to increase in value ten fold. The money would be used for projects such as improving the operations of electric cars, advanced fiber optics, turning used tires into electricity, turning garbage into railroad ties, and developing a gold mine. Investors were falsely told there was no risk and that Logan City was a partner. Docket No. SD-06-0052.

Aug. 3, 2006. The Division issued a petition proposing to revoke the securities licenses of **Walnut Street Securities** and **Richard W. Mack**. The petition also asks that Mack and **Carole Turner** be barred from the securities industry. An Order to Show Cause also was issued against **Roy N. Hafen** of Santa Clara. The petition alleges that while Hafen was a securities agent for Walnut, he raised \$3.2 million from 12 investors for an outside business venture. Mack has filed suit against the Division to enjoin the licensing action. The case is in litigation. Docket No. SD-06-0040.

Aug. 4, 2006. The Division issued an Order to Show Cause

against **Bennie Smith** and his company **Blacksmith Management Group**, of Salt Lake. Smith and Blacksmith are accused of taking \$150,000 from an investor to fund secret government contracts. The investigation revealed that the government contracts did not exist and the money was used to pay personal expenses. The investor was promised 10% interest on the money and was told property in Las Vegas secured the investment. Docket No. SD-06-0056.

Aug. 8, 2006. An order to cease and desist was entered against **Jordan Tenney** for selling unregistered factoring investments in accounts receivable by CommuniCom Direct, Inc., a cable installer. An investor spent \$295,800 buying 52 factoring agreements from Tenney and his father, John B. Tenney. Jordan Tenney was controller for the company and signed the factoring agreements. Many of the factoring agreements were sold by the father during a time that John Tenney had been convicted of securities fraud for a previous factoring scheme and was awaiting sentencing. Some of the investor's money was used to pay defense costs in his criminal case. Jordan Tenney consented to the order and paid a fine. Docket No. SD-05-0074.

Aug. 14, 2006. **Bruce A. Hill** of Washington County consented to a cease and desist order for selling unregistered oil and gas investments. Hill took \$25,000 from an investor,



“Anderson said the money would be used for electric cars, fiber optics, turning used tires into electricity, turning garbage into railroad ties, and developing a gold mine.”



Enforcement - Continued

a widow, promising a 200% return within 30 days. He claimed the investment was backed by an existing oil and gas lease in Texas. Hill also paid a fine of \$30,000. Docket No. SD-06-0039.

Aug. 15, 2006. A default order was entered against **Peak Funding** and **Leland Wheeler** of Garden City, New York. They fraudulently induced an investor to send over \$14,000 based on a promise of receiving a low-interest loan of \$300,000. The investor was falsely told the money would be held in escrow. The default was entered after Peak and Wheeler failed to respond to the Division's allegations. Docket No. SD-06-0029.

Aug. 15, 2006. **Video Projects** was ordered to cease and desist for violating securities laws by taking \$550,000 from investors supposedly to be used for a computer training business. Instead, the investor money was used for personal expenses of company officials. Investors were falsely told the owner had a net worth of \$16 million and that the company would soon go public. The order was entered by default after the company failed to respond to the Division's action. The case is still pending against the company owner. Docket No. SD-06-0026.

Aug. 15, 2006. A cease and desist order was entered by

default against **CommuniCom Direct**, for selling \$295,800 in factoring investments then using the money to pay personal expenses of the officers. An order had been entered previously against its treasurer Jordan Tenney. Docket No. SD-05-0075.

Aug. 16, 2006. Two major orders were entered to remedy misconduct by a New York boiler room operation. **The Thornwater Company**, a New York broker-dealer and **Robert Grabowski**, former president of Thornwater consented to separate orders resolving allegations they permitted Thornwater stockbrokers to manipulate the accounts of a Utah customer, resulting in \$147,000 in losses. Securities agents at the firm improperly managed customer accounts by making unauthorized margin purchases, permitting sales by unlicensed agents, recording false information, engaging in excessive trading, and failing to halt trading at the customer's request. The accounts lost 92% of their value. Based on their failure to properly supervise the agents, Thornwater paid a \$100,000 fine and Grabowski paid a \$15,000 fine and agreed never to be licensed in Utah. Three other Thornwater agents have previously consented to orders entered by the Division. Restitution has been paid to the customer. The orders were approved by the Advisory Board. Docket No. SD-02-0140.

Aug. 16, 2006. **Richard Benton** of Salt Lake consented to

an order prohibiting him from acting as a supervisor and requiring that he pay a \$5,000 fine for permitting an agent he supervised to mismanage a customer's accounts. The agent made unsuitable trades in the customer's accounts and conducted excessive trading, causing the account to lose value dramatically. The order was approved by the Advisory Board. The broker-dealer, Round Hill Securities had consented to an order previously and repaid the customer. Docket No. SD-05-0022.

Aug. 16, 2006. The Securities Advisory Board approved a consent order against **Wachovia Capital Markets** of Charlotte, North Carolina. The order resolves allegations of potential conflicts of interest between research analysts and investment bankers at Wachovia. Wachovia failed to supervise its employees adequately to ensure there were no conflicts of interest and failed to maintain proper e-mail records. In the order, Wachovia agreed to cease and desist from conducting inadequate supervision and pay \$246,500 in fines. Docket No. SD-06-0054.

Aug. 23, 2006. An emergency cease and desist order was issued against **Flavor Bands, Inc.** and its officers, **J.D. Pulver**, **Tim Haskin**, and **Denise Sullivan**. Respondents, based out of Las Vegas, are accused of forming a new Utah corporation with the same name as a former public company from Utah, then trying to pass the new company off as the succes-

sor. They appeared to want to sell insider stock to the public using the manual trading exemption. The transfer agent notified the Division of the scheme and refused to participate. Docket No. SD-06-0057.

Aug. 29, 2006. The Davis County Attorney filed criminal charges against **Oscar W. Mink**, of Lake Arrowhead, California, for taking \$300,000 in 2002 from an investor in Bountiful to expand the business of Rodizio's restaurant. The charges allege Mink failed to disclose risks to the investor, including the precarious financial condition of the company. It declared bankruptcy later that year. Two partners of Mink were charged in 2004.

Sept. 1, 2006. **Karon C. Cook**, of Bountiful, agreed to pay \$100,000 in fines and be barred from the securities industry for brokering loans for clients, borrowing money from a client, holding herself out as an investment adviser when she was not so licensed, and serving as a trustee for client accounts — all without disclosing these activities to the firm. She also filed an application and amendments with the Division containing false information. Docket No. SD-05-0060.

Sept. 1, 2006. **Richard E. Haskell** consented to the entry of an order barring him from the securities industry was entered by the Division. Haskell admitted that while he was a securities agent for WMA Securities, he persuaded another agent to give him \$10,000 to use in his separate business, Haskell Professional Services. He gave a note to the

Enforcement - Continued

investor, promising 24% interest. He falsely told the investor there was no risk and failed to disclose unpaid tax liens. He falsified records submitted to his broker-dealer. Payment of \$10,000 in fines was waived based on his inability to pay. Docket No. SD-06-0007.

Sept. 5, 2006. The broker-dealer license of **GEO Securities** of Dallas Texas was cancelled. GEO appeared to have ceased conducting business based on its failure to respond to requests for information and an NASD suspension. Docket No. SD-06-0064.

Sept. 6, 2006. **Jared W. DeWitt** of Cedar Hills and his company **DeWitt Investments** consented to an order that they cease and desist from offering securities. This is the case described in the July newsletter where a flier was posted on doors in a neighborhood offering 21% profit from real estate flipping. Investors were told that the interest and principal on their promissory notes were guaranteed. A fine of \$25,000 was imposed. Docket No. SD-06-0063.

Sept. 11, 2006. An order to show cause was issued alleging fraud in connection with a car investment scheme promoted by **Dennis T. Wynn** of Salt Lake County and two of his companies, **DFTF Financial Group** and **Arizona Cyber Auto**. Investors put \$82,026 in the scheme in which the investors would provide funding to purchase cars that would be resold. Profits would be shared with the investors. The order alleges that some of the

money was used to pay personal expenses and that investors were not told of a prior bankruptcy, unpaid judgments and tax liens, and a prior criminal charge. Docket No. SD-06-0067.

Sept. 11, 2006. The Utah Attorney General announced that **Kevin L. Wright** and **Michael S. Hurst** were sentenced for their equity-skimming investment scheme. They had pled guilty on July 17 (described above). Wright was ordered to serve 20 days in jail. Both were placed on two years probation and ordered to provide 500 hours of community service. The investor was repaid.

Sept. 14, 2006. **City Lips Cosmetics**, **City Lips Marketing**, **Jory C. Allen**, **Chad D. Wright**, and **Frank J. Gillen** were ordered to show cause why they should not be ordered to cease violating the securities laws. The order alleges City Lips raised \$454,000 from investors to grow the cosmetics company, launch new products, increase inventory, and take the company public. Investors were not told that Gillen had a prior \$25,000 fine imposed for selling unregistered securities and that his securities license was revoked. Docket No. SD-06-0068.

Sept. 22, 2006. A cease and desist order was imposed by default against **Thomas M. Johnson** of Burbank, California for selling stock to an investor when Johnson did not own the stock. Johnson did not disclose

his prior criminal convictions. A \$50,000 fine was imposed.

This concludes the administrative action initiated in June 2006. Separate criminal proceedings are pending against Johnson (see above). Docket No. SD-06-0032.

Sept. 26, 2006. The Attorney General filed five felony counts of securities fraud and exploitation of a senior against **Glenn Allen Britt** of Layton. Britt is accused of taking \$139,000 from three investors by selling promissory notes in a company called Cantamar. He told victims their money would be used for construction loans and would earn 20% interest. One victim was elderly and living on a fixed income. He also failed to disclose a prior bankruptcy and two unpaid judgments. Britt pleaded guilty in March 2005 to securities fraud for a related scheme.

Sept. 29, 2006. **Bradley R. Keyser** of South Jordan was ordered to show cause why a cease and desist order should not be entered against him. Keyser is accused of taking \$130,000 from two investors as capital for his credit card processing company. He promised a 10% return on the promissory notes and said investors would earn more money than they could ever spend. Some of the money was used to pay utility bills, buy groceries, make religious donations, and pay car expenses. He failed to disclose unpaid judgments and a prior bankruptcy. Docket No. SD-06-0074.



“Based on their failure to properly supervise the agents, Thornwater paid a \$100,000 fine and Grabowski paid a \$15,000 fine and agreed never to be licensed in Utah.”





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Division Statistics

Licensing Activity	This Quarter	Sept. 30 Total
Broker-dealers	32	1,688
Broker-dealer agents	2713	74,979
Investment advisers (state)	18	159
Investment adviser representatives	223	2,030
Issuer agents	6	77
Filing Activity		YTD
Coordination registration	24	89
Qualification registration	0	1
Mutual funds/UITs	1,225	3,378
Regulation D filings	249	710
Exemption filings	9	32

